

AR82



2006
ANNUAL REPORT

Profile Pine Cliff Energy Ltd. (TSX Venture symbol – PNE) is a junior energy company that explores for, develops and produces oil and natural gas in the Western Sedimentary Basin in Canada and internationally.

The Company's business strategy is to strive to maximize shareholder value by applying long-term growth objectives. The Company's primary objective is to combine its oil and gas production strengths with planned business strategies to generate above average results and returns for its shareholders.

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Notice of Annual General Meeting

The Annual General Meeting of Shareholders will be held on Thursday, May 24, 2007, in the Nakiska Room at the Westin Hotel, 320 Fourth Avenue S.W., Calgary, Alberta, at 9:00 a.m. (Calgary time).

Forward-Looking Information

Certain information set forth in this document, including management's assessment of Pine Cliff Energy Ltd.'s ("the Company" or "Pine Cliff") future plans and operations, contains forward-looking statements. By their nature, forward-looking statements are subject to numerous risks and uncertainties, some of which are beyond Pine Cliff's control, including the impact of general economic conditions, industry conditions, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, environmental risks, competition from other industry participants, the lack of availability of qualified personnel or management, stock market volatility and ability to access sufficient capital from internal and external sources. Readers are cautioned that the assumptions used in the preparation of such information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements. Pine Cliff's actual results, performance or achievement could differ materially from those expressed in, or implied by these forward-looking statements, and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking statements will transpire or occur, or if any of them do so, what benefits Pine Cliff will derive therefrom. Pine Cliff disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Readers are cautioned that net present value of reserves does not represent fair market value of reserves.

Highlights

	2006	2005 ⁽¹⁾
Revenue – Oil and Gas	\$ 661,100	\$ 633,873
Funds flow from Operations (2)	(424,248)	368,259
Per Share Basic	(0.01)	0.01
Per Share Fully Diluted	(0.01)	0.01
Net Loss	(1,014,605)	(329,062)
Per Share Basic	(0.03)	(0.01)
Per Share Fully Diluted	(0.03)	(0.01)
Capital Expenditures and Acquisitions	271,926	2,097,930
Shareholders' Equity	4,239,638	5,110,407
Shares Outstanding (December 31)	36,523,041	36,420,041
Operations		
Oil and Liquids (barrels per day)	5	7
Average Price (\$ per barrel)	63.88	62.42
Natural Gas (MCF per day)	195	175
Average Price (\$ per MCF)	7.58	10.78
Total Barrels per Day (BOE per day) (3)	38	36
Reserves ⁽⁴⁾		
Oil and Liquids (barrels)		
Proved Developed Producing (Gross)	10,200	13,300
Proved plus Probable (Gross)	13,700	21,400
Natural Gas (MCF)		
Proved Developed Producing (Gross)	326,000	352,000
Proved plus Probable (Gross)	440,000	568,000
Share Trading Statistics		
Share Prices (based on daily closing price)		
High	\$ 0.76	\$ 0.61
Low	\$ 0.40	\$ 0.42
Close	\$ 0.65	\$ 0.55
Daily Average Trading Volume	3,754	7,535

(1) Operations commenced April 8, 2005

(2) Funds flow from operations is not a recognized measure under GAAP. Management believes that in addition to net earnings, funds flow from operations is a useful supplemental measure as it demonstrates the Company's ability to generate the cash necessary to fund future growth through capital investment. Investors are cautioned, however, that this measure should not be construed as an indication of the Company's performance. The Company's method of calculating this measure may differ from other issuers and accordingly, it may not be comparable to that used by other issuers. For these purposes, the Company defines funds flow from operations as funds provided by operations before changes in non-cash operating working capital items excluding foreign exchange loss and asset retirement expenditures.

(3) BOE's are calculated using a conversion ratio of 6 MCF to 1 barrel of oil. The conversion is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead and as such may be misleading if used in isolation.

(4) Gross reserves relate to the Company's ownership of reserves before royalty interests.

Report to Shareholders

Pine Cliff Energy Ltd. ("Pine Cliff" or the "Company") is pleased to report its operational and financial results for 2006. Much of the year's efforts were directed towards activities in South America. Staffing and becoming familiar with regulations and business philosophies in both Argentina and Chile were necessary prior to proceeding with the acquisition of properties.

Operations

These efforts are now being rewarded. In Q1, 2007, Pine Cliff's 93 percent owned subsidiary, CanAmericas Energy Ltd. ("CanAmericas"), was successful in negotiating two major farm-in arrangements in Argentina. One has been completed and the other is subject to completion of CanAmericas due diligence. The farm-ins will result in earning interests in a total of 912,810 gross acres (542,410 net acres) of exploration and exploitation lands. For more details kindly refer to "Property Discussions" of this report. Negotiations are ongoing with regard to the acquisition of additional exploration, exploitation and producing properties.

The Company is pleased with the progress that CanAmericas is making in South America. The geological potential and size of these concessions is extraordinary. A land position of this magnitude is extremely difficult to obtain and provides the potential for a large number of drill locations.

In 2007 Pine Cliff will also increase its activities in Canada. The focus will be to acquire production and to participate in more drilling.

Finance

Additional funding will be required to complete commitments for the Argentina farm-ins and for further activities in Canada as well as in South America. Pine Cliff is presently reviewing financing alternatives and expects to complete a financing transaction during Q2, 2007.

The Company is now well positioned to proceed internationally as well as in Canada and will be aggressively proceeding in both areas in 2007. The Board of Directors wish to take this opportunity to thank its shareholders for their patience and support and to the staff and consultants for their many contributions and assistance during the past year.

Submitted on behalf of the Board of Directors,



George F. Fink
President, CEO, & Director

Review of Operations

Reserves

The Company engaged the services of Sproule Associates Limited to prepare a reserve evaluation with an effective date of December 31, 2006. The reserves are located in the Province of Alberta. The majority of the Company's production is comprised of natural gas. The Company's main gas producing area is located in the Sundance area of West Central Alberta. The gross reserve figure in the following charts represents the Company's ownership interest before royalties and the net figure is after deductions for royalties.

Summary of Oil and Gas Reserves as of December 31, 2006

(Forecast Prices and Costs)

Reserve Category	Reserves			
	Natural Gas		Natural Gas Liquids	
	Gross (MMcf)	Net (MMcf)	Gross (Mbbbl)	Net (Mbbbl)
Proved				
Developed Producing	326	249	10	7
Total Proved	326	249	10	7
Probable	114	87	4	2
Total Proved Plus Probable	440	336	14	9

Reconciliation of Company Gross Reserves by Principal Product Type

(Forecast Prices and Costs)

	Natural Gas		
	Gross Proved (MMcf)	Gross Probable (MMcf)	Gross Proved Plus Probable (MMcf)
December 31, 2005	352	216	568
Technical Revisions	45	(102)	(57)
Production	(71)	–	(71)
December 31, 2006	326	114	440

Summary of Net Present Values of Future Net Revenue as at December 31, 2006

(Forecast Prices and Costs)

Reserve Category (M\$)	Net Present Value of Future Net Revenue After Income Taxes Discounted at (%/year)				
	0	5	10	15	20
Proved					
Developed Producing	1,722	1,519	1,362	1,237	1,135
Total Proved	1,722	1,519	1,362	1,237	1,135
Probable	483	346	258	200	161
Total Proved Plus Probable	2,205	1,865	1,620	1,437	1,296

Year	Edmonton Par Price (Cdn \$ per barrel)	Alberta Gas Reference Price Plantgate (Cdn \$ per MCF)	Propane (Cdn \$ per barrel)	Butane (Cdn \$ per barrel)	Pentane (Cdn \$ per barrel)
2007	74.10	7.51	43.94	55.23	75.88
2008	77.62	8.38	46.03	57.85	79.49
2009	70.25	7.55	41.66	52.36	71.94
2010	65.56	7.37	38.88	48.87	67.14
2011	61.90	7.54	36.71	46.14	63.40
2012	63.15	7.68	37.45	46.07	64.67
2013	64.42	7.79	38.21	48.02	65.98
2014	65.72	7.93	38.97	48.98	67.30
2015	67.04	8.07	39.76	49.97	68.66
2016	68.39	8.21	40.56	50.97	70.04
2017	69.76	8.35	41.38	52.00	71.45

Natural gas and liquid prices escalate at various rates thereafter.

The following cautionary statements are specifically required by NI 51-101.

It should not be assumed that the estimates of future net revenue presented in the above tables represent the fair market value of the reserves. There is no assurance that the forecast prices and costs assumptions will be attained and variances could be material.

Disclosure provided herein in respect of BOE's may be misleading, particularly if used in isolation. In accordance with NI 51-101, a BOE conversion ratio of 6mcf:1bbl has been used in all cases in this disclosure. This BOE conversion ratio is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

Estimates of reserves and future net revenues for individual properties may not reflect the same confidence level as estimates of reserves and future net revenues for all properties due to the effects of aggregation.

Land Holdings

The Company's holdings of natural gas leases and rights as of December 31, 2006 are as follows:

	2006		2005	
	Gross Acres	Net Acres	Gross Acres	Net Acres
Alberta	7,360	2,802	7,680	2,844

Petroleum and Natural Gas Capital Expenditures

The following table summarizes petroleum and natural gas capital expenditures incurred by the Company on acquisitions, land, seismic, exploration and development drilling and production facilities for the years ended December 31:

	2006	2005
Exploration and development costs	\$ 226,193	\$1,089,632
Acquisitions	—	999,701
Land costs	—	5,490
Seismic	—	2,433
Net petroleum and natural gas capital expenditures	\$ 226,193	\$2,097,256

Drilling History

The following table summarizes the Company's gross and net drilling activity and success:

	2006					
	Development		Exploratory		Total	
	Gross	Net	Gross	Net	Gross	Net
Natural Gas	1	0.1	–	–	1	0.1
Success rate	100%	100%	–	–	100%	100%

	2005					
	Development		Exploratory		Total	
	Gross	Net	Gross	Net	Gross	Net
Natural Gas	2	0.2	–	–	2	0.2
Dry	–	–	1	1.0	1	1.0
Total	2	0.2	1	1.0	3	1.2
Success rate	100%	100%	–	–	67%	16.7%

Property Discussions

Pine Cliff's only producing property is located in the Sundance area of West Central Alberta. The Company has a 13.7% average working interest in 5,280 acres (723 net) of Crown land in the area. There are currently 5 (0.53 net) wells producing. The wells produce from multiple zones from the Cadomin to the Belly River. Current production from the five wells is approximately 2,660 mcf/day gross, 305 mcf/day net to Pine Cliff. NGL's are produced in association with the natural gas.

There is still significant industry activity in the Sundance area. With the success of last year's drilling program the interests in non producing properties are being analyzed to determine whether there are additional prospective drilling locations. The increased activity in the area has caused bottlenecks in non-interest gathering systems and gas plants causing some of our wells to be shut-in from time to time over the last year. Increases in facility capacity and re-routing of a portion of our production have alleviated these problems at this time.

In 2006 Pine Cliff had decided to pursue oil and gas opportunities in South America. In 2007, the Company has been successful in negotiating two separate farm-in agreements to acquire an interest in 40 gross townships (912,810 acres) (net 24 townships (542,410 acres)) of land.

HydroCarbon Basins In Argentina



Oran, Tarija Basins (-)

"big" gas producers
complex structures
difficult drilling
very high operating costs

Cuyo Basin (-)

good oil production
multiple, complex reservoirs
limited exploration upside

Neuquen Basin (+)

high oil production rates
multiple reservoirs
abundant infrastructure
reasonable operating costs
mature oil exploration area

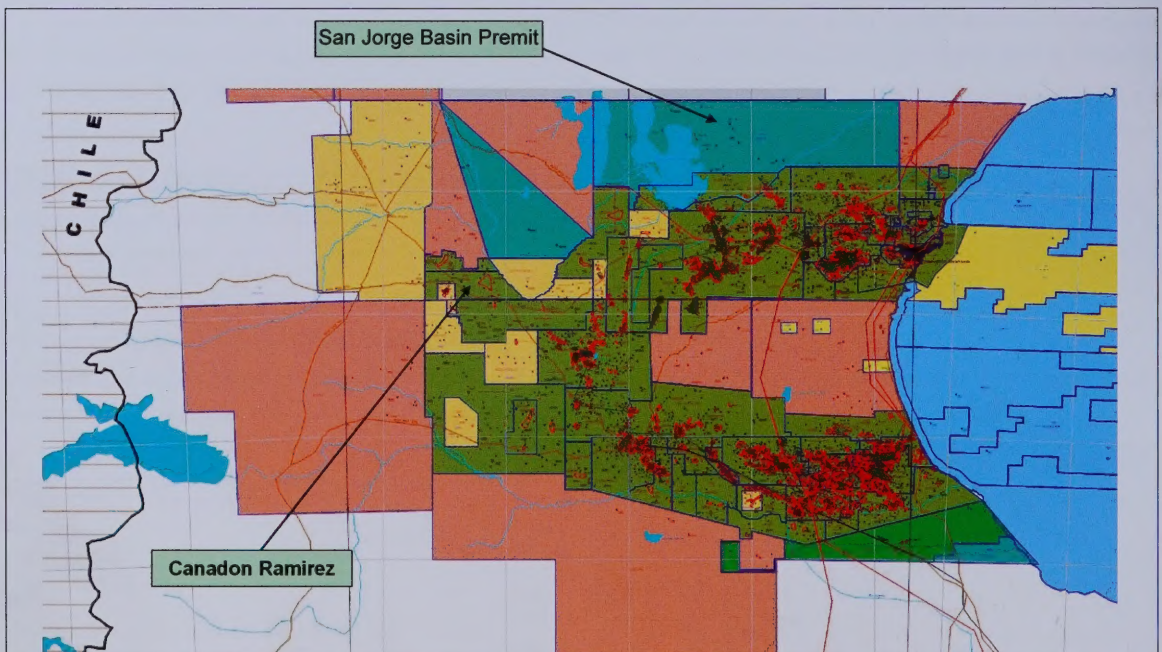
San Jorge Basin (+)

long-life, oil production
multiple reservoirs
complex reservoirs
immature oil exploration/develop

Austral Basin (-)

high gas/oil production rates
simple reservoirs
lack of infrastructure
immature gas exploration/develop

Location of Properties in San Jorge Basin

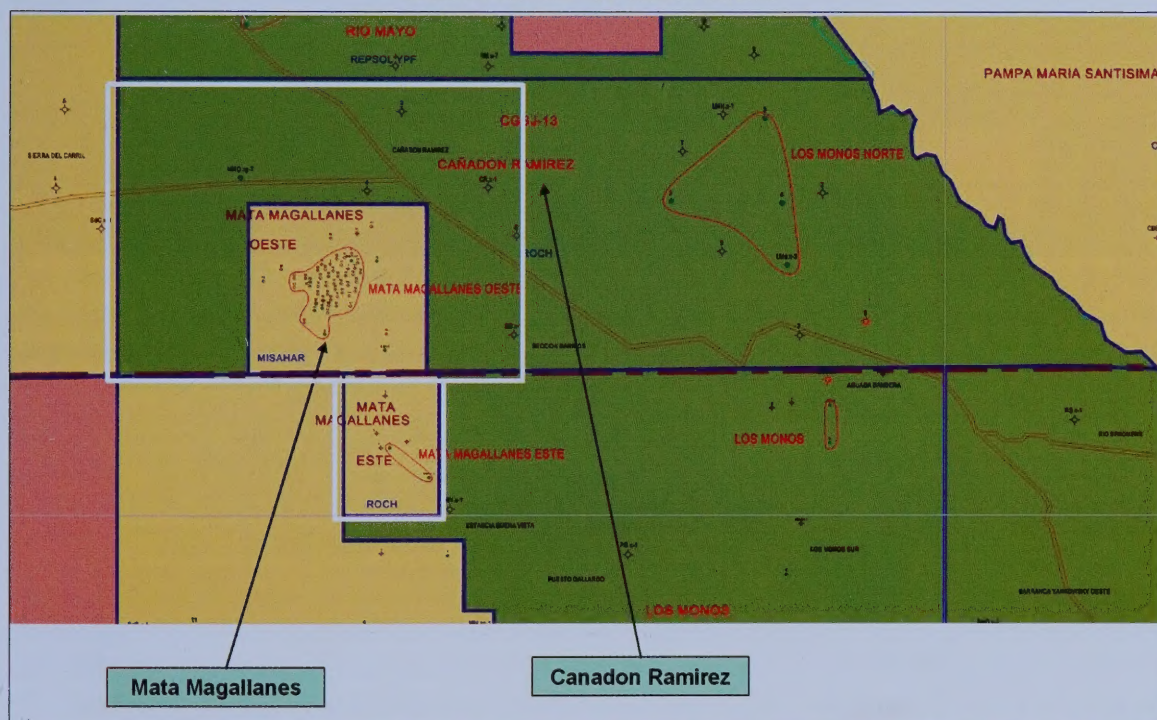


Cañadón Ramirez Farm-In

The Company through its 93 percent owned subsidiary, CanAmericas Energy Ltd. ("CanAmericas") has earned a 49% interest in 47,940 gross acres (23,490 net acres) of an exploitation concession situated in the western part of the San Jorge Basin by committing to fund 100% of exploration costs totaling \$US 5,500,000 over the next two years. The commitment includes conducting a 3D seismic program and drilling three wells in the first year at an estimated cost of \$US 4,630,000. In the second year of the commitment CanAmericas is committed to spend the remainder of the \$US 5,500,000 on drilling.

The acreage is bordered by several producing oil fields. Over 40 separate prospective reservoirs belonging to the Upper-Mid Cretaceous-aged Bajo Barreal and Castillo Formations, are known to exist within the farm-in area at depths between 1950 – 5000 feet. Additionally, Neocomian aged source rocks within the farm-in area have been proven to be oil generating and over pressured.

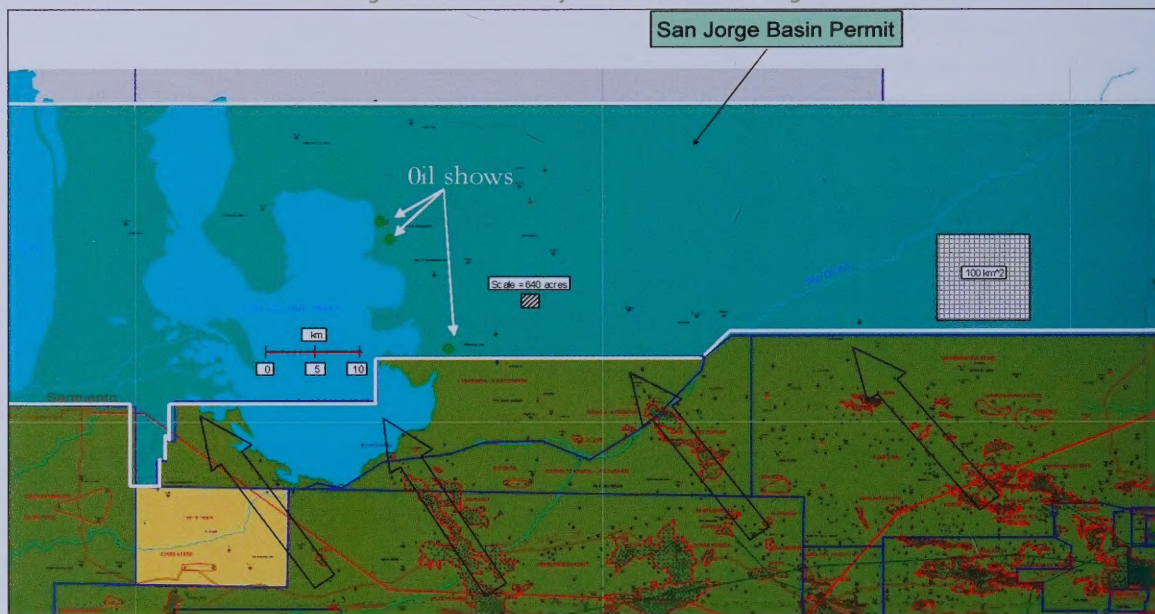
Cañadón Ramirez - 3D Seismic Outline



CanAmericas is currently conducting a 75 square mile 3D seismic survey which is to be completed by the end of May. It is the first such program to be recorded over the producing and earned areas that will permit detailed stratigraphic and structural mapping of multiple leads that were initially developed from existing 2D coverage. An agreement was made with an adjacent operator to trade seismic data providing us with data over a total of 93 square miles. This will allow CanAmericas to tie in its seismic data to seismic conducted over an existing producing oil field. A drilling rig has been contracted and drilling of three prospects is scheduled to begin by August, 2007.

San Jorge Basin Farm-In

San Jorge Basin Permit Projected Known Producing Trends



The Company through its 93 percent owned subsidiary, CanAmericas, has negotiated exclusive rights to progressively earn a 60% interest in 864,870 gross acres (518, 920 net acres) of an exploration permit situated in the north-central San Jorge basin. CanAmericas has the right to become operator of the Permit and will likely decide to do so after it has completed its due diligence.

Subject to completion of the due diligence, the exclusive rights commit CanAmericas to fund 100% of the costs to conduct an aero-magnetic and aero-gravity survey over the entire permit area, acquire 39 square miles of 3D seismic, and drill two exploration wells to earn a 30% participating interest in the entire permit. The surveys are to be completed within one year of the effective date of the agreement and the wells are to be drilled within two years of the effective date.

CanAmericas will earn an additional 30% in the entire permit by drilling two additional wells within three years of the effective date of the agreement. CanAmericas will receive 100 percent of cash flow from this property until it has recovered 100 percent of its costs for the two work programs. The estimated cost for both work programs is \$US 4,620,000. After completion of the two work programs costs will be shared on a 60 percent CanAmericas and 40 percent farmor basis.

Principal reservoir objectives are multiple sands of the Upper-Mid Cretaceous Bajo Barreal and Castillo Formations which are known to exist throughout the permit at depths ranging between 1000 – 5000 feet. A producing oil field lies adjacent to the southern border of this permit and existing seismic data and well control suggests the productive trend may extend into the southern portion of this permit. Additionally, numerous oil and gas shows encountered by older wells drilled throughout the permit during the 1960's – 1980's prove that the permit contains an active hydrocarbon system.

CanAmericas will initially acquire the regional aero-gravity and aero-magnetic surveys over the entire permit and with this information, and existing well and 2D seismic coverage, will determine where to best conduct the required 3D seismic survey. The 3D coverage is expected to assist in better understanding stratigraphic environments that were previously identified from existing 2D seismic coverage.

Management's Discussion and Analysis

The following report dated April 13, 2007 is a review of the operations, current financial position and outlook for the Company and should be read in conjunction with the audited financial statement for the period ended December 31, 2006, including the notes related thereto.

Forward-Looking Information

Certain statements contained in this MD&A include statements which contain words such as "anticipate", "could", "should", "expect", "seek", "may", "intend", "likely", "will", "believe" and similar expressions, statements relating to matters that are not historical facts, and such statements of our beliefs, intentions and expectations about development, results and events which will or may occur in the future, constitute "forward-looking information" within the meaning of applicable Canadian securities legislation and are based on certain assumptions and analysis made by us derived from our experience and perceptions. Forward-looking information in this MD&A includes, but is not limited to: expected cash provided by continuing operations; future capital expenditures, including the amount and nature thereof; oil and natural gas prices and demand; expansion and other development trends of the oil and natural gas industry; business strategy and outlook; expansion and growth of our business and operations; and maintenance of existing customer, supplier and partner relationships; supply channels; accounting policies; credit risks; and other such matters.

All such forward-looking information is based on certain assumptions and analyses made by us in light of our experience and perception of historical trends, current conditions and expected future developments, as well as other factors we believe are appropriate in the circumstances. The risks, uncertainties, and assumptions are difficult to predict and may affect operations, and may include, without limitation: the risks of foreign operations; foreign exchange fluctuations; equipment and labour shortages and inflationary costs; general economic conditions; industry conditions; changes in applicable environmental, taxation and other laws and regulations as well as how such laws and regulations are interpreted and enforced; the ability of oil and natural gas companies to raise capital; the effect of weather conditions on operations and facilities; the existence of operating risks; volatility of oil and natural gas prices; oil and gas product supply and demand; risks inherent in the ability to generate sufficient cash flow from operations to meet current and future obligations; increased competition; stock market volatility; opportunities available to or pursued by us; and other factors, many of which are beyond our control. The foregoing factors are not exhaustive and are further discussed herein under the heading Business Prospects, Risks and Outlooks.

Actual results, performance or achievements could differ materially from those expressed in, or implied by, this forward-looking information and, accordingly, no assurance can be given that any of the events anticipated by the forward-looking information will transpire or occur, or if any of them do, what benefits will be derived therefrom. Except as required by law, Pine Cliff disclaims any intention or obligation to update or revise any forward-looking information, whether as a result of new information, future events or otherwise.

The forward-looking information contained herein is expressly qualified by this cautionary statement.

Disclosure Controls and Procedures

Disclosure controls and procedures are defined under Multilateral Instrument 52-109 – Certification of Disclosure Controls in Issuers' Annual and Interim Filings ("MI 52-109") as "... controls and other procedures of an issuer that are designed to provide reasonable assurance that information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted by it under provincial and territorial securities legislation is recorded, processed, summarized and reported within the time periods specified in the provincial and territorial securities legislation and include, without limitation, controls

and procedures designed to ensure that information required to be disclosed by an issuer in its annual filings, interim filings or other reports filed or submitted under provincial and territorial securities legislation is accumulated and communicated to the issuer's management, including its chief executive officers and chief financial officers (or persons who perform similar functions to a chief executive officer or a chief financial officer), as appropriate to allow timely decisions regarding required disclosure." The Company has conducted a review and evaluation of its disclosure controls and procedures, with the conclusion that as at December 31, 2006 the Company has an effective system of disclosure controls and procedures as defined under MI 52-109. In reaching this conclusion, the Company recognizes that two key factors must be and are present:

1. the Company is very dependent upon its advisors and consultants (principally its legal counsels) to assist in recognizing, interpreting, understanding and complying with the various securities regulations disclosure requirements; and
2. an active Board and management with open lines of communications.

The Company has a small staff with varying degrees of knowledge concerning the various regulatory disclosure requirements. In many circumstances, the various regulatory requirements are relatively new, subject to interpretation, and complex. The Company is not of sufficient size to justify a separate department or one or more staff member specialists in this area. Therefore the Company must rely upon its advisors/consultants to assist it and as such they form part of the disclosure controls and procedures.

Proper disclosure necessitates that a person not only be aware of the pertinent disclosure requirements, but must also be sufficiently involved in the affairs of the Company and/or receives the communication of information to assess any necessary disclosure requirements. Accordingly, it is essential that there be proper communication among those people who manage and govern the affairs of the Company, this being the Board of Directors and senior management. The Company believes this communication exists.

While the Company believes it has adequate disclosure controls and procedures in place, lapses in the disclosure controls and procedures could occur and/or mistakes could happen. Should such occur, the Company intends to take whatever steps it deems necessary to minimize the consequences thereof.

Internal Controls Overs Financial Reporting

Internal controls over financial reporting are defined in MI 52-109 as "... a process designed by, or under the supervision of, the issuer's chief executive officers and chief financial officers, or persons performing similar functions, and effected by the issuer's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer's GAAP and includes those policies and procedures that:

1. pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the issuer;
2. provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with the issuer's GAAP, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer; and
3. provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the issuer's assets that could have a material effect on the annual financial statements or interim financial statements."

The Company has conducted a review and evaluation of its internal controls over financial reporting, with the conclusion that as of December 31, 2006, the Company's system of internal controls over financial reporting as defined under MI 52-109 is adequately designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. In its evaluation, the Company identified certain material weaknesses in internal controls over financial reporting:

1. due to the limited number of staff at the Company, it is not feasible to achieve the complete segregation of incompatible duties; and
2. due to the limited number of staff, the Company relies upon third parties as participants in the Company's internal controls over financial reporting.

The Company believes these weaknesses are mitigated by: the active involvement of senior management and the board of directors in the affairs of the Company; open lines of communication within the Company; the present levels of activities and transactions within the Company being readily transparent; the thorough review of the Company's financial statements by management, the board of directors and by the Company's auditors (annual statements only); and the establishment of a whistle-blower policy. However, these mitigating factors will not necessarily prevent a material misstatement occurring as a result of the aforesaid weaknesses in the Company's internal controls over financial reporting. A system of internal controls over financial reporting, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the internal controls over financial reporting are met.

Financial and Operational

The Company was incorporated in the Province of Alberta on November 10, 2004 and commenced operations on April 8, 2005.

Annual Financial and Operational Highlights

	2006	2005
Revenue - Oil and Gas	\$ 661,100	\$ 633,873
Funds Flow from Operations (1)	(424,248)	368,259
Per Share Basic	(0.01)	0.01
Per Share Diluted	(0.01)	0.01
Net Loss	(1,014,605)	(329,062)
Per Share Basic	(0.03)	(0.01)
Per Share Diluted	(0.03)	(0.01)
Capital Expenditures and Acquisitions	271,926	2,097,930
Total Assets	4,494,010	5,267,988
Working Capital	2,963,513	3,565,689
Shareholder's Equity	4,239,638	5,110,407
Operations		
Oil and Liquids (barrels per day)	5	7
Natural Gas (MCF per day)	195	175

Quarterly Financial and Operational Highlights

2006	4th	3rd	2nd	1st
Revenue - Oil and Gas	\$ 170,231	\$ 90,386	\$ 108,413	\$ 292,070
Funds Flow from Operations ⁽¹⁾	(51,833)	(113,095)	(337,020)	77,700
Per Share Basic	(0.00)	(0.00)	(0.01)	0.00
Per Share Diluted	(0.00)	(0.00)	(0.01)	0.00
Net Loss	(209,575)	(211,784)	(526,107)	(67,139)
Per Share Basic	(0.01)	(0.01)	(0.01)	(0.00)
Per Share Diluted	(0.01)	(0.01)	(0.01)	0.00
Capital Expenditures and Acquisitions	19,227	(3,463)	124,236	131,926
Total Assets	4,494,010	4,700,305	4,892,079	5,373,147
Working Capital	2,963,513	3,030,822	3,175,577	3,625,133
Shareholder's Equity	4,239,638	4,411,915	4,589,015	5,093,951
Operations				
Oil and Liquids (barrels per day)	3	5	4	9
Natural Gas (MCF per day)	226	131	139	284
2005	4th	3rd	2nd	1st
Revenue - Oil and Gas	\$ 372,315	\$ 121,141	\$ 140,417	\$ -
Funds Flow from Operations ⁽¹⁾	275,942	68,119	48,374	(24,176)
Per Share Basic	0.01	0.00	0.00	(0.00)
Per Share Diluted	0.01	0.00	0.00	(0.00)
Net Loss	(223,241)	(37,092)	(44,553)	(24,176)
Per Share Basic	(0.01)	(0.00)	(0.00)	(0.00)
Per Share Diluted	(0.01)	(0.00)	(0.00)	(0.00)
Capital Expenditures and Acquisitions	160,809	321,206	1,615,915	-
Total Assets	5,267,988	5,609,386	5,481,085	192,458
Working Capital (Deficiency)	3,565,689	3,450,555	3,513,801	(185,983)
Shareholder's Equity	5,110,407	5,305,042	5,308,028	(24,175)
Operations				
Oil and Liquids (barrels per day)	8	4	6	-
Natural Gas (MCF per day)	279	116	153	-

(1) Funds flow from operations is not a recognized measure under GAAP. Management believes that in addition to net earnings, funds flow from operations is a useful supplemental measure as it demonstrates the Company's ability to generate the cash necessary to fund future growth through capital investment. Investors are cautioned, however, that this measure should not be construed as an indication of the Company's performance. The Company's method of calculating this measure may differ from other issuers and accordingly, it may not be comparable to that used by other issuers. For these purposes, the Company defines funds flow from operations as funds provided by operations before changes in non-cash operating working capital items excluding foreign exchange loss and asset retirement expenditures.

Production

On April 8, 2005, with an effective date of January 1, 2005, the Company acquired interests in two natural gas properties for a cash payment of \$999,701. The Sundance land, located in West Central Alberta was the major property acquired. Pine Cliff acquired a 13.2 percent working interest (subject to Crown royalty) in 4,320 acres in this area. There are two wells (0.308 net) on these lands that have been producing for approximately two years. Two additional multi-zone wells were drilled in 2005 (net 0.2) and a further well (0.038 net) was drilled in 2006. In 2006 production averaged 195 MCF (2005 – 175 MCF) of natural gas and five barrels (2005 – 7 barrels) of natural gas liquids per day.

During the second quarter of 2006, the operator of the gas plant, where approximately 80 percent of the Company's production is processed, performed an annual turnaround resulting in the significant reduction in production for that period. Subsequent to the completion of the turnaround, capacity restrictions resulted in the continued shut-in of the Company's production. In September the capacity restrictions were resolved and the Company's production resumed.

Pine Cliff also acquired a 100 percent interest in a 256 hectare Crown lease in the Auburndale area of East Central Alberta. The Company drilled a Devonian well for sweet natural gas during 2005. The Company tested the well and concluded that the projected production volume is not sufficient to construct a five kilometer pipeline to tie it in. The drilling and land costs were written off in 2005.

Revenue

Revenue from petroleum and natural gas sales for 2006 was \$661,100 compared to \$633,873 in 2005. The increase of \$27,227 was due to higher production volumes offset by lower commodity prices. Average price received in 2006 for its natural gas was \$7.58 (2005 - \$10.78) per MCF and \$63.88 (2005 - \$62.42) per barrel for natural gas liquids. The Company did not have hedging agreements in either 2006 or 2005 and presently does not have any future hedging agreements.

Fourth quarter petroleum and natural gas sales increased to \$170,231 from \$90,386 in the third quarter. The increase is due to full production from the Sundance property as well as higher natural gas prices.

Royalties

Royalties consist of Crown royalties paid to the Province of Alberta and gross overriding royalties. In 2006 the Company recorded a net recoverable amount of \$1,054 in Crown royalties compared to a Crown royalty expense of \$17,464 in 2005. The operator of the Sundance property applied for and received a Crown royalty holiday in respect of the wells drilled in 2005. As customary in the industry, Crown royalties were paid on this well until the royalty holiday was granted. As a result of the Crown royalty holiday, the Company recovered in 2006 the full amount of the \$17,464 paid in 2005. The royalty holiday has expired in 2006 and the Company is now paying royalties on this production.

Gross overriding royalties of \$26,723 (2005 - \$21,366) were recorded in 2006. There has been no significant change to the rates over the two years or quarter over quarter.

Interest Income

The Company maintains an investment account with its principal banker that pays interest at prime less 2.25 percent as long as the Company maintains a minimum balance of \$1,500,000. The Company in March 2007 drew down on the outstanding cash balance to finance its seismic expenditure commitment in Argentina. Please refer to Business Prospects Section.

Production Costs

Production costs for the year ended December 31, 2006, were \$132,346 (2005 - \$53,449) or \$9.62 (2005 - \$5.41) per BOE (Q4 – \$10.90 per BOE, Q3 – \$9.37 per BOE). BOE's are calculated using a conversion ratio of 6 MCF to 1 barrel of oil. The conversion

is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead and as such may be misleading if used in isolation. Due to capacity constraints at the gas plant, the Company is incurring increased processing fees in relation to its Sundance gas production.

General and Administrative

General and administrative expenses for 2006 were \$1,043,866 (Q4 - \$254,226) compared to \$239,417 for 2005 and \$220,442 for the third quarter of 2006. The primary reason for the increase in 2006 expenses was due to the Company incurring \$621,621 in administration costs related to its activities in South America. The majority of the South American costs related to engineering and consulting fees of \$408,651, travel and accommodation costs of \$92,121, and legal costs of \$96,559.

Pine Cliff does not have any employees at the present time but has engaged Comstate Resources Ltd. ("Comstate") a related party (see Related Party section), to provide management services and engages the services of consultants on a contract or temporary basis. Pine Cliff's subsidiary CanAmericas Energy Ltd. ("CanAmericas") has also engaged the services of two individual professionals as senior management and officers of CanAmericas.

In addition to the above South American costs, increases in geological consulting fees of \$18,490 (Canadian operations); audit, accounting and engineering costs of \$65,874 for year end audit and financial reporting and \$84,000 in management fees (see Related Party section) were incurred in 2006.

Foreign Exchange Loss

In February 2006, the Company incorporated a subsidiary company, CanAmericas to explore and develop oil and gas properties primarily in South America. CanAmericas is owned 93 percent by the Company and seven percent by a foreign private corporation ("Foreign Corp."). CanAmericas was initially financed with \$1,400,000 U.S. for 5,600,000 common shares from the Company and \$100,000 U.S. for 400,000 common shares from Foreign Corp. The loss on foreign exchange of \$2,448 relates to the appreciation of the Canadian dollar from the date of the above share issuance to December 31, 2006. The fourth quarter saw the Canadian dollar give up most of the amount it gained during the first nine months of 2006.

Stock Based Compensation

Stock based compensation for the year ended December 31, 2006, was \$128,385 (2005 - \$87,041). The Company has a stock-based compensation plan for Pine Cliff. The Company records a compensation expense over the vesting period based on the fair value of options granted to employees, directors and consultants. The Company issued 895,000 stock options in Pine Cliff during 2006. The Company estimated the stock options fair value at \$191,458 (\$0.21 per option) using the Black-Scholes option pricing model, assuming a weighted average risk free interest rate of 4.13 percent, weighted average expected volatility of 63.1 percent, weighted average expected life of 2.5 years and no annual dividend rate.

Dry Hole Exploration Costs

As previously discussed, the Company drilled a Devonian gas well in the second quarter of 2005. The well, although capable of production, did not contain sufficient reserves to warrant a five kilometer pipeline. Given the lack of current economics for this well, no proved or probable reserves were assigned to the well in the preparation of the third party engineering report. With the Company following the successful efforts method of accounting (see below), capital costs associated with each field that are in excess of that field's economic value are to be written off. As such the Company wrote off \$6,222 (2005 - \$588,256) in respect of the cost of the land and development costs incurred in drilling the Devonian well.

Depletion, Depreciation and Amortization

The Company follows the successful efforts method of accounting for petroleum and natural gas properties and related

equipment. Costs of acquiring unproved properties are capitalized. When petroleum and natural gas properties are found to contain proved reserves as determined by Company engineers, the related net book value is depleted on the unit-of-production basis, calculated by field. The costs of dry holes and abandoned properties are charged to operations. Geological costs, lease rentals and carrying costs are charged to income as incurred. Costs of drilling exploratory and development wells that result in additions to proved reserves are capitalized and depleted on the unit-of-production basis. Tangible equipment is depreciated on a straight-line basis over ten years.

Provisions are made for asset retirement obligations through the recognition of the fair value of obligations associated with the retirement of tangible long-life assets being recorded in the period the asset is put into use, with a corresponding increase to the carrying amount of the related asset. The obligations recognized are statutory, contractual or legal obligations. The liability is adjusted over time for changes in the value of the liability through accretion charges which are included in depletion, depreciation and accretion expense. The costs capitalized to the related assets are amortized to earnings in a manner consistent with the depletion and depreciation of the underlying asset.

At December 31, 2006, the estimated total undiscounted amount required to settle the asset retirement obligations was \$71,031 (2005 - \$42,796). These obligations will be settled based on the useful lives of the underlying assets, which extend up to 13 years into the future. This amount has been discounted using a credit-adjusted risk-free interest rate of five percent. The discount rate is reviewed annually and adjusted if considered necessary. A change in the rate would not have a significant impact on the amount recorded for asset retirement obligations.

The calculation of the above requires an estimation of the amount of the Company's petroleum reserves by field. This figure is calculated annually by an independent engineering firm and used to calculate depletion. This calculation is to a large extent subjective. Reserve adjustments are affected by economic assumptions as well as estimates of petroleum products in place and methods of recovering those reserves. To the extent reserves are increased or decreased, depletion costs will vary.

Income Taxes

The Company follows the liability method of accounting for income taxes under which the income tax provision is based on the temporary differences in the accounts calculated using income tax rates expected to apply in the year in which the temporary differences will reverse. The Company has sufficient tax pools so it is not liable for current income tax in 2006. Due to the decline in natural gas prices as well as the moderate decrease in estimated reserves, the ability to claim the tax benefits of the following tax pools is no longer more likely than not and as such the Company has recorded a full valuation allowance to eliminate the future tax asset.

The Company has the following tax pools which can be used to reduce future taxable income:

	Rate of Utilization	
	%	Amount
Undepreciated capital costs	25	\$ 305,936
Canadian oil and gas property expenditures	10	728,371
Canadian development expenditures	30	398,588
Canadian exploration expenditures	100	392,110
Share issue costs	20	100,588
Non-capital loss carryforward (expires 2016)	100	757,797
		\$ 2,683,390

Non-Controlling Interest

As described above, Foreign Corp. owns seven percent of CanAmericas. The \$38,701 of loss applicable to non-controlling interest relates to their share of revenues and costs associated with CanAmericas' South American activities.

The loss for the 2006 fiscal year is \$1,014,605 (\$209,575 in the fourth quarter) compared to \$329,062 in 2005 and \$211,784 in the third quarter of 2006. The 2006 loss was predominantly due to general and administrative costs incurred in respect of the Company's South American operations as well as a future tax adjustment. Please see Business Prospects Section for discussions regarding future activities.

Funds Flow from Operations

Funds flow from operations decreased to negative \$424,248 in 2006 from a positive \$368,259 in 2005. The decrease from the 2005 amount was mainly due to the Company's activities in South America. Quarter over quarter saw a reduction in the funds flow loss due to increased funds flow from the Company's oil and natural gas operations.

The following reconciliation compares funds flow for the fiscal years ended December 31, 2006, and 2005 to the Company's cash flow from operating activities as calculated according to Canadian generally accepted accounting principles:

	2006	2005
Cash flow from operating activities	(\$168,809)	\$25,764
Items not affecting funds flow		
Due from related party	(16,006)	16,006
Accounts receivable	(154,329)	339,329
Prepaid expenses	(806)	3,460
Accounts payable and accrued liabilities	(117,138)	(16,135)
Due to related party	165	(165)
Asset retirement obligations settled	35,123	–
Foreign exchange loss	(2,448)	–
Funds flow for the period	(\$424,248)	\$368,259

Related Party Transactions

Pine Cliff also has a management agreement with Comstate, a wholly owned subsidiary of Bonterra Energy Income Trust and a company with common directors and management with Pine Cliff, to have Comstate provide executive services (President and CEO, CFO and COO), accounting services, oil and gas administration and office administration. The management fee consists of a monthly fee of \$18,000 (2005 - \$12,000), three percent of net earnings before income taxes, plus out of pocket costs. Total fees for 2006 were \$216,000 (2005 - \$132,000) plus minimal out of pocket costs. No amounts were owing to or from Comstate as of December 31, 2006. In 2005 there was a net receivable from Bonterra Energy Income Trust of \$15,841 relating to a post closing adjustment for the assets purchased from Novitas Energy Ltd.

Commitments and Business Prospects

As discussed above, the Company has a management agreement with Comstate which can be cancelled by giving 90 day's notice.

Subsequent to year end the Company entered into commitments in relation to its farm-ins on two parcels of land in Argentina. Please see previous Property Discussions section for further details. A summary of the commitments is provided below:

Canadon Ramirez Concession

CanAmericas has committed to pay 100% of costs totaling \$5,500,000 US, including the 21% Value Added Tax ("V.A.T."), for work to be conducted on the concession within two years to earn a 49% participating interest. The work in the first year includes conducting and interpreting a 75 square mile 3D seismic program and drilling three wells. In the second year of the commitment CanAmericas is committed to spend the remainder of the \$5,500,000 US on drilling.

Commitment by Year (\$000's US)

Year	Amount
2007	4,630
2008	870
	5,500

San Jorge Basin Permit

CanAmericas is committed to pay 100% of the costs totalling \$4,620,000 US including V.A.T. to conduct an aero-magnetic and aero-gravity survey over the entire permit area, a 3D seismic survey over 39 square miles in the concession area and drill four wells to earn a 60% participating interest in the entire permit. The surveys are to be completed within one year of the effective date, the first two wells are to be drilled within two years of the effective date, and the remaining two wells are to be drilled within three years of the effective date. The costs for this project are subject to cost recovery from cash flow obtained from the wells drilled in this work program.

Commitment by Year (\$000's US)

Year	Amount
2007	300
2008	2,595
2009	1,725
	4,620

Proceeds from Financing Activities

The following compares the proposed use of proceeds as per the Company's initial public offering document dated March 9, 2005, to that spent up to December 31, 2006:

	Actual	Offering Document ⁽¹⁾
Gross Proceeds:	\$5,463,005	\$5,641,385
Use of Proceeds:		
Costs of the Issue (including obtaining listing on the TSX Venture Exchange)	(167,647)	(125,000)
Acquisition of the Acquisition Property (2)	(999,100)	(761,000)
Exploration and Development Drilling (3)	(1,374,160)	(2,170,000)
Proceeds remaining for working capital	\$2,922,098	\$2,585,385

(1) Maximum Offering

- (2) Closing of the Acquisition Property occurred in April 2005 but was effective January 1, 2005. During the interim the operator of one of the properties commenced its drill program. Under Canadian generally accepted accounting principles the drilling costs incurred prior to closing are to be considered as part of the cost of the property. As such approximately \$286,000 of exploration and development costs originally contemplated in the initial public offering were recorded as acquisition costs for accounting purposes.
- (3) The Company had originally planned on drilling several follow-up locations on the Sundance property. This has not been done.

The Company plans on using the balance of the exploration and development drilling funds on seismic costs related to its Argentina commitments. Please see discussion under Business Prospects.

Liquidity and Capital Resources

As of December 31, 2006, Pine Cliff had positive working capital of \$2,963,513 (December 31, 2005 - \$3,565,689). These funds will be used to fund financial commitments as discussed under Commitments. The Company plans on financing the balance of its commitments through the issue of additional common shares and company cash flow.

The Company is authorized to issue an unlimited number of common shares without nominal or par value.

	2006		2005	
	Number	Amount	Number	Amount
Common Shares				
Balance, beginning of year	36,420,041	\$5,352,428	10	\$ 1
Issued pursuant to public offering	—	—	36,420,031	5,463,005
Share issue costs	—	—	—	(167,647)
Issued on exercise of stock options	103,000	15,450	—	—
Transfer of contributed surplus to share capital	—	9,465	—	—
Future tax benefit of share issue costs	—	—	—	57,069
Balance, end of year	36,523,041	\$5,377,343	36,420,041	\$5,352,428

A summary of the status of the Company's stock option plan as of December 31, 2006 and December 31, 2005, and changes during the years ended on those dates is presented below:

	December 31, 2006		December 31, 2005	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding at beginning of year	1,686,000	\$0.16	-	\$0.00
Options granted	895,000	0.52	1,752,000	0.16
Options exercised	(103,000)	0.15	-	-
Options cancelled	(58,000)	0.21	(66,000)	0.15
Outstanding at end of year	2,420,000	\$0.29	1,686,000	\$0.16
Options exercisable at end of year	740,000	\$0.16	-	\$0.00

Options Outstanding			Options Exercisable		
Range of Exercise Prices	Number Outstanding At 12/31/06	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable At 12/31/06	Weighted-Average Exercise Price
\$0.15	1,515,000	3.1 years	\$0.15	730,000	\$0.15
0.50 – 0.60	825,000	3.1 years	0.50	10,000	0.59
0.70 – 0.75	80,000	3.1 years	0.72	–	–
\$0.15 – 0.75	2,420,000	3.1 years	\$0.29	740,000	\$0.16

The Company records compensation expense over the vesting period based on the fair value of options granted to employees, directors and consultants. The Company issued 895,000 stock options with an estimated fair value of \$191,458 (\$0.21 per option) using the Black-Scholes option pricing model with the following key assumptions:

Weighted-average risk free interest rate (%)	4.13
Dividend yield (%)	0.00
Expected life (years)	2.5
Weighted-average volatility (%)	63.1

The Company's subsidiary CanAmericas issued an option to Foreign Corp. during the first quarter of 2006 to acquire 1,000,000 common shares of CanAmericas at an option price of \$0.25 US per common share. The options vest 50 percent on each of January 13, 2007, and January 13, 2008, and expire on January 13, 2011.

Sensitivity Analysis

Given the current start up status of the Company changes of \$1.00 US per barrel in the price of crude oil, \$0.10 per MCF in the price of natural gas, or a \$0.01 change in the Cdn/US exchange rate would have no significant impact on the cash flow per unit amounts for the Company.

Additional information relating to the Company may be found on WWW.SEDAR.COM and by visiting its website at www.pinecliffenergy.com.

Submitted on behalf of the Board of Directors,



George F. Fink

President, CEO and Director

Management's Responsibility for Financial Statements

The information provided in this report, including the financial statements, is the responsibility of management. In the preparation of the statements, estimates are sometimes necessary to make a determination of future values for certain assets or liabilities. Management believes such estimates have been based on careful judgements and have been properly reflected in the accompanying financial statements.

Management maintains a system of internal controls to provide reasonable assurance that the Company's assets are safeguarded and to facilitate the preparation of relevant and timely information.

Deloitte & Touche LLP has been appointed by the shareholders to serve as the Company's external auditors. They have examined the financial statements and provided their auditors' report. The audit committee has reviewed the financial statements with management and the auditors, and has reported to the Board of Directors. The Board of Directors has approved the financial statements as presented.



George F. Fink
President and CEO



Garth E. Schultz
Vice President, Finance and CFO

Auditors' Report

To the Shareholders of Pine Cliff Energy Ltd.:

We have audited the consolidated balance sheets of Pine Cliff Energy Ltd. as at December 31, 2006 and 2005 and the consolidated statements of loss and deficit and cash flow for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Calgary, Alberta
April 13, 2007



Chartered Accountants

Consolidated Balance Sheets

For the years ended December 31

	2006	2005
Assets		
Current		
Cash	\$ 2,915,020	\$ 3,334,961
Due from related party (Note 2)	–	16,006
Accounts receivable	185,001	339,330
Prepaid expenditures	2,654	3,460
	3,102,675	3,693,757
Future Income Tax Asset (Note 4)	–	216,254
Property and Equipment (Note 5)		
Property and equipment	1,848,887	1,538,809
Accumulated depletion and depreciation	(457,552)	(180,832)
	1,391,335	1,357,977
	\$ 4,494,010	\$ 5,267,988
Liabilities		
Current		
Accounts payable and accrued liabilities	\$ 139,162	\$ 127,903
Due to related party (Note 2)	–	165
	139,162	128,068
Asset Retirement Obligations (Note 6)	40,240	29,513
Non-controlling Interests (Note 3)	74,970	–
	254,372	157,581
Commitments (Notes 8 and 11)		
Shareholders' Equity		
Share capital (Note 7)	5,377,343	5,352,428
Contributed surplus	205,962	87,041
Deficit	(1,343,667)	(329,062)
	4,239,638	5,110,407
	\$ 4,494,010	\$ 5,267,988

On Behalf of the Board:



George F. Fink
Director



F. William Woodward
Director

Consolidated Statements of Loss and Deficit

For the years ended December 31

Revenue

	2006	2005
Oil and gas sales	\$ 661,100	\$ 633,873
Royalties	(25,669)	(38,830)
Alberta royalty tax credits	—	4,366
Interest income	118,981	61,715
	754,412	661,124

Expenses

Production costs	132,346	53,449
General and administrative	1,043,866	239,417
Foreign exchange loss	2,448	—
Stock based compensation	128,385	87,041
Dry hole exploration costs (Note 5)	6,222	588,256
Depletion, depreciation and accretion	278,197	181,208
	1,591,464	1,149,371

Loss Before Income Taxes and Non-controlling Interests	(837,052)	(488,247)
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Income Taxes Provision (Recovery) (Note 4)

Current	—	—
Future	216,254	(159,185)
	216,254	(159,185)

Loss before Non-Controlling Interests	(1,053,306)	(329,062)
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Loss applicable to non-controlling interests (Note 3)	38,701	—
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Loss for the Year	(1,014,605)	(329,062)
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Deficit, beginning of year	(329,062)	—
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Deficit, end of year	\$ (1,343,667)	\$ (329,062)
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Loss Per Share – Basic and Diluted (Note 7)	\$ (0.03)	\$ (0.01)
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Consolidated Statements of Cash Flow

For the years ended December 31

Operating Activities

	2006	2005
Loss for the year	\$ (1,014,605)	\$ (329,062)
Items not affecting cash		
Stock based compensation	128,385	87,041
Dry hole exploration costs	6,222	588,256
Depletion, depreciation and accretion	278,197	181,208
Foreign exchange loss	2,448	—
Future income taxes (recovery)	216,254	(159,185)
Loss applicable to non-controlling interests	(38,701)	—
	(421,800)	368,258
Change in non-cash working capital		
Due from related party	16,006	(16,006)
Accounts receivable	154,329	(339,328)
Prepaid expenditures	806	(3,460)
Accounts payable and accrued liabilities	117,138	16,135
Due to related party	(165)	165
Asset retirement obligations settled	(35,123)	—
	252,991	(342,494)
Cash Provided by (Used in) Operating Activities	(168,809)	25,764

Financing Activities

Share option proceeds	15,450	—
Issue of shares by subsidiary to non-controlling interests	113,670	—
Proceeds received on initial public offering	—	5,463,005
Issue costs	—	(88,802)
Change in non-cash working capital		
Accounts payable and accrued liabilities	—	(25,000)
Due to related party	—	(53,845)
Cash Provided by Financing Activities	129,120	5,295,358

Investing Activities

Property and equipment expenditures	(271,926)	(2,097,930)
Change in non-cash working capital		
Accounts payable and accrued liabilities	(105,878)	111,768
Cash Used In Investing Activities	(377,804)	(1,986,162)
Foreign Exchange Loss on Cash Held in Foreign Currency	(2,448)	—
Net Cash Inflow (Outflow)	(419,941)	3,334,960
Cash, Beginning of Year	3,334,961	1
Cash, End of Year	\$ 2,915,020	\$ 3,334,961
Cash Interest Paid	\$ —	\$ —
Cash Taxes Paid	\$ —	\$ —

Notes to the Financial Statements

For the Years Ended December 31, 2006 and 2005

1. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles as described below.

Consolidation

These financial statements include the accounts of the Company and its 93 percent owned subsidiary CanAmericas Energy Ltd. ("CanAmericas") (see note 3). Inter-company transactions and balances are eliminated upon consolidation.

Measurement Uncertainty

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and revenues and expenses during the reporting period. Actual results can differ from those estimates.

In particular, amounts recorded for depreciation and depletion and amounts used in ceiling test calculations are based on estimates of petroleum and natural gas reserves and future costs required to develop those reserves. The Company's reserve estimates are evaluated annually by an independent engineering firm. By their nature, these estimates of reserves and the related future cash flows are subject to measurement uncertainty, and the impact on the consolidated financial statements of future periods could be material.

The amounts recorded for asset retirement obligations were estimated based on the Company's net ownership interest in all wells and facilities, estimated costs to abandon and reclaim the wells and facilities and the estimated period during which these costs will be incurred in the future. Any changes to these estimates could change the amount recorded for asset retirement obligations and may materially impact the consolidated financial statements of future periods.

Petroleum and Natural Gas Properties and Related Equipment

The Company follows the successful efforts method of accounting for petroleum and natural gas properties and related equipment. Costs of exploratory wells are initially capitalized pending determination of proved reserves. Costs of wells which are assigned proved reserves remain capitalized, while costs of unsuccessful wells are charged to earnings. All other exploration costs including geological and geophysical costs are charged to earnings as incurred. Development costs, including the cost of all wells, are capitalized.

Producing properties and significant unproved properties are assessed annually or as economic events dictate, for potential impairment. Impairment is assessed by comparing the estimated net undiscounted future cash flows to the carrying value of the asset. If required, the impairment recorded is the amount by which the carrying value of the asset exceeds its fair value.

Depreciation and depletion of capitalized costs of oil and gas producing properties are calculated using the unit of production method. Development and exploration drilling and equipment costs are depleted over the remaining proved developed reserves. Depreciation of other plant and equipment is provided on the straight line method. Straight line depreciation is based on the estimated service lives of the related assets which is estimated to be ten years.

Furniture, Equipment and Other

These assets are recorded at cost and are depreciated on a straight line basis over five to ten years.

Income Taxes

The Company follows the liability method of accounting for income taxes under which the income tax provision is based on the temporary differences between the amounts reported by the Company and their respective tax bases calculated using income tax rates expected to apply in the year in which the temporary differences will reverse.

Asset Retirement Obligations

The Company recognizes the fair value of obligations associated with the retirement of long-life assets in the period the asset is put into use, with a corresponding increase to the carrying amount of the related asset. The obligations recognized are statutory, contractual or legal obligations. The liability is adjusted over time for changes in the value of the liability through accretion charges which are included in depletion, depreciation and accretion expense. The costs capitalized to the related assets are amortized to earnings in a manner consistent with the depletion and depreciation of the underlying asset.

Stock-based Compensation

The Company has a stock-based compensation plan which is described in Note 7. The Company records compensation expense over the vesting period based on the fair value of options granted to employees, directors and consultants. These amounts are recorded as contributed surplus. Any consideration paid by employees, directors or consultants on the exercise of these options is recorded as share capital together with the related contributed surplus associated with the exercised options.

Revenue Recognition

Petroleum and natural gas sales are recognized when the commodities are delivered and title transfers to the purchasers.

Foreign Currency Translation

The Company translates foreign currency denominated monetary assets and liabilities of its integrated foreign subsidiary at the exchange rate in effect at the balance sheet date and non-monetary assets and liabilities are translated at historical exchange rates. Revenues and expenses are translated at estimated transaction date exchange rates except depletion and depreciation expense, which is translated at the same historical exchange rates as the related assets. Exchange gains or losses are included in the determination of net income as foreign exchange gain or loss.

Joint Interest Operations

Significant portions of the Company's oil and gas operations are conducted with other parties and accordingly the financial statements reflect only the Company's proportionate interest in such activities.

Earnings Per Share

Basic earnings per share is computed by dividing the earnings by the weighted average number of shares outstanding during the year. Diluted per share amounts reflect the potential dilution that could occur if options to purchase common shares were exercised. The treasury stock method is used to determine the dilutive effect of common share options, whereby proceeds from the exercise of common share options or other dilutive instruments are assumed to be used to purchase common shares at the average market price during the year.

2. RELATED PARTY TRANSACTIONS

Bonterra Energy Income Trust ("Bonterra"), an organization with common directors and management and the former parent of the Company, through its wholly owned subsidiaries Comstate Resources Ltd. ("Comstate"), Bonterra Energy Corp. ("Bonterra Corp.") and Novitas Energy Ltd. ("Novitas") has provided working capital, management services and has sold natural gas properties to the Company. Fees paid for management services totalled \$216,000 (2005 - \$132,000) for the year. The management services agreement may be cancelled by the Company with 90 days notice.

As of December 31, 2006, the Company owed Nil (2005 - \$165) to Bonterra and its wholly owned subsidiaries for these items. The Company has an account receivable from Novitas of Nil (December 31, 2005 - \$16,006) relating to post closing adjustments in relation to the natural gas properties acquired.

3. NON-CONTROLLING INTERESTS

The Company incorporated a subsidiary company, CanAmericas, to explore and develop oil and gas properties primarily in South America. CanAmericas is owned 93.3 percent by the Company and 6.7 percent by a foreign private corporation ("Foreign Corp."). CanAmericas was initially financed by investments of \$1,400,000 U.S. for 5,600,000 common shares from the Company and \$100,000 U.S. for 400,000 common shares from Foreign Corp.

Foreign Corp. has been granted an option to acquire an additional 1,000,000 common shares of CanAmericas at \$0.25 U.S. per common share. The options vest 50 percent on each of January 13, 2007 and January 13, 2008 and expire on January 13, 2011.

4. INCOME TAXES

The Company recorded a future income tax asset in 2005 as at that time management considered its recoverability to be more likely than not. As of December 31, 2006, it was determined that this criteria was not met and as such the entire amount of the future income tax asset was fully offset by a valuation allowance.

	2006	2005
Future income tax assets:		
Capital assets	\$125,932	\$158,295
Asset retirement obligation	11,670	10,454
Share issue costs	29,171	47,505
Loss carry-forward (expires 2016)	215,798	-
Valuation allowance	(382,571)	-
	\$ -	\$216,254

Income tax expense differs from the amounts that would be computed by applying Canadian federal and provincial income tax rates as follows:

	2006	2005
Loss before income taxes and non-controlling interests	\$(837,052)	\$(488,247)
Combined federal and provincial income tax rates	34.5%	37.6%
Income tax provision calculated using statutory tax rates	(288,783)	(183,679)
Increase (decrease) in income taxes resulting from:		
Stock based compensation	44,293	32,745
Non-deductible crown royalties	329	4,667
Resource allowance	(4,854)	(19,059)
Change in valuation allowance	382,571	—
Change in tax rates	84,195	—
Other	(1,497)	6,141
Income tax provision (recovery)	\$ 216,254	\$(159,185)

The Company has the following tax pools, which may be used to reduce taxable income in future years, limited to the applicable rates of utilization:

	Rate of Utilization	
	%	Amount
Undepreciated capital costs	25	\$ 305,936
Canadian oil and gas property expenditures	10	728,371
Canadian development expenditures	30	398,588
Canadian exploration expenditures	100	392,110
Share issue costs	20	100,588
Non-capital loss carryforward (expires 2016)	100	757,797
		\$ 2,683,390

5. PROPERTY AND EQUIPMENT

	2006		2005	
	Cost	Accumulated Depletion and Depreciation	Cost	Accumulated Depletion and Depreciation
Undeveloped land	\$ 5,538	\$ —	\$ 5,490	\$ —
Petroleum and natural gas properties and related equipment	1,797,586	450,365	1,533,319	180,832
Furniture, equipment and other	45,763	7,187	—	—
	\$1,848,887	\$ 457,552	\$1,538,809	\$ 180,832

On April 8, 2005, the Company purchased its original properties from Bonterra (see Note 2) for approximately \$1,000,000 in cash, with an effective date of January 1, 2005. The properties included one producing property and some exploration lands. The transaction was concluded between the related parties at fair value.

In 2006, the Company wrote off \$6,222 (2005 - \$588,256) in respect of the cost of the land and exploration costs incurred in drilling an exploratory well. The well, although capable of production, does not contain sufficient reserves to warrant tie-in. Given the lack of current economics for this well, no proved or probable reserves were assigned to the well in the preparation of the third party engineering report.

6. ASSET RETIREMENT OBLIGATIONS

At December 31, 2006, the estimated total undiscounted amount required to settle the asset retirement obligations was \$71,031 (December 31, 2005 - \$42,796). Costs for asset retirement have been calculated assuming a 5 percent inflation rate for 2007, 4 percent for 2008, 3 percent for 2009 and 2 percent thereafter. These obligations will be settled based on the useful lives of the underlying assets, which extend up to 13 years into the future. This amount has been discounted using a credit-adjusted risk-free interest rate of 5 percent.

Changes to asset retirement obligations were as follows:

	2006	2005
Asset retirement obligations, December 31	\$29,513	\$ —
Obligations associated with acquisition and development programs	—	29,138
Adjustment to asset retirement obligation	44,375	—
Liabilities settled during the year	(35,123)	—
Accretion	1,475	375
Asset retirement obligations, December 31	\$40,240	\$29,513

7. SHARE CAPITAL

Authorized

Unlimited number of Common Shares without nominal or par value.

Unlimited number of Class B Preferred Shares without nominal or par value which may be issued in one or more series.

Issued	2006		2005	
	Number	Amount	Number	Amount
Common Shares				
Balance, beginning of year	36,420,041	\$5,352,428	10	\$ 1
Issued pursuant to public offering	–	–	36,420,031	5,463,005
Share issue costs	–	–	–	(167,647)
Issued on exercise of stock options	103,000	15,450	–	–
Transfer of contributed surplus to share capital	–	9,465	–	–
Future tax benefit of share issue costs	–	–	–	57,069
Balance, end of year	36,523,041	\$5,377,343	36,420,041	\$5,352,428

The number of common shares used to calculate diluted loss per share for the year ended December 31, 2006 is 36,477,619 (December 31, 2005 – 27,545,132). The exercise of outstanding stock options would have no dilutive effect on per share amounts.

On April 7, 2005, the Company concluded its initial public offering of 36,420,031 Common Shares at \$0.15 per share for gross proceeds of \$5,463,005. The Company granted 930,000 stock options to its directors and officers, and an additional 802,000 stock options to other service providers at an exercise price of \$0.15 per share. The Company commenced trading on the TSX Venture Exchange on April 11, 2005.

The Company may grant options for up to 3,605,583 (2005 – 3,605,583) common shares. The exercise price of each option granted equals the market price of the common share on the date of grant and the options' maximum term is five years.

A summary of the status of the Company's stock option plan as of December 31, 2006 and December 31, 2005, and changes during the years ended on those dates are presented below:

	December 31, 2006		December 31, 2005	
	Options	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Outstanding at beginning of year	1,686,000	\$0.16	–	\$0.00
Options granted	895,000	0.52	1,752,000	0.16
Options exercised	(103,000)	0.15	–	–
Options cancelled	(58,000)	0.21	(66,000)	0.15
Outstanding at end of year	2,420,000	\$0.29	1,686,000	\$0.16
Options exercisable at end of year	740,000	\$0.16	–	\$0.00

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding At 12/31/06	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable At 12/31/06	Weighted-Average Exercise Price
\$0.15	1,515,000	3.1 years	\$0.15	730,000	\$0.15
0.50 – 0.60	825,000	3.1 years	0.50	10,000	0.59
0.70 – 0.75	80,000	3.1 years	0.72	–	–
\$0.15 – 0.75	2,420,000	3.1 years	\$0.29	740,000	\$0.16

The Company records compensation expense over the vesting period based on the fair value of options granted to employees, directors and consultants. Unvested options as of December 31, 2006 vest 872,500 in 2007 and 807,500 in 2008.

The Company issued 895,000 stock options with an estimated fair value of \$191,458 (\$0.21 per option) using the Black-Scholes option pricing model with the following key assumptions in 2006:

Weighted-average risk free interest rate (%)	4.13
Dividend yield (%)	0.00
Expected life (years)	2.5
Weighted-average volatility (%)	63.1

8. COMMITMENTS

Commencing February 1, 2005, the Company entered into a management agreement with Comstate (see Note 2). The management agreement consists of a monthly fee of \$18,000 (2005 - \$12,000) per month plus out of pocket costs, a fee of three percent of net earnings before income taxes, \$250 per month per operated producing well and \$150 per month per water injector well.

For commitments entered into subsequent to December 31, 2006 please see Note 11.

9. FINANCIAL INSTRUMENTS

Fair Values

The Company's financial instruments included in the balance sheet are comprised of due from related party, accounts receivable and current liabilities. The fair values of these financial instruments approximate their carrying value due to the short-term maturity of those instruments.

Credit Risk

Substantially all of the Company's accounts receivable are due from customers in the oil and gas industry and are subject to normal industry credit risks. The carrying value of accounts receivable reflects management's assessment of associated credit risks.

Commodity Price Risk

The Company's operations and financial results may be affected by fluctuations in commodity prices and exchange rates.

Currency Risk

The Company is exposed to fluctuations in foreign currency as a result of its South American operations. The Company has not entered into any foreign currency derivatives with respect to this exposure.

10. SEGMENTED INFORMATION

The Company, with the incorporation of CanAmericas in February, 2006, has operations in Canada and South America; all operating activities are related to exploration, development and production of petroleum and natural gas as follows:

(\$)	Canada	South America	Total
Twelve Months Ended December 31, 2006 ⁽¹⁾			
Revenue, gross	729,332	50,749	780,081
Loss before non-controlling interest	472,797	580,509	1,053,306
Property and equipment	1,352,759	38,576	1,391,335
Capital expenditures	226,163	45,763	271,926
Total assets	3,254,440	1,239,570	4,494,010

(1) Prior to the incorporation of CanAmericas all of the Company's operations were in Canada and as such no prior period information has been provided.

11. SUBSEQUENT EVENT - COMMITMENT

Subsequent to December 31, 2006, the Company entered into two farm-in agreements in South America which require future expenditure commitments as outlined below:

Canadon Ramirez Concession

Pine Cliff through its 93 percent owned subsidiary, CanAmericas, has committed to pay 100% of costs totalling \$5,500,000 US, including the 21% Value Added Tax ("V.A.T."), for work to be conducted on the concession within two years to earn a 49% participating interest.

Commitment by Year (\$000's US)

Year	Amount
2007	4,630
2008	870
	<u>5,500</u>

San Jorge Basin Permit

Pine Cliff through its 93 percent owned subsidiary, CanAmericas, has committed to pay 100% of costs totalling \$4,620,000 US including V.A.T. to earn a 60% participating interest in the entire permit.

Commitment by Year (\$000's US)

Year	Amount
2007	300
2008	2,595
2009	1,725
	<u>4,620</u>

Board of Directors

G.J. Drummond, Nassau, Bahamas

G.F. Fink, Calgary, Alberta

C.R. Jonsson, Vancouver, British Columbia

F. W. Woodward, Calgary, Alberta

Officers

G.F. Fink – President & Chief Executive Officer

R.M. Jarock – Chief Operating Officer

G.E. Schultz – Vice President Finance, Chief Financial
Officer & Secretary

Registrar & Transfer Agent

Olympia Trust Company, Calgary, Alberta

Auditors

Deloitte & Touche LLP, Calgary, Alberta

Solicitors

Borden Ladner Gervais LLP, Calgary, Alberta

Bankers

The Royal Bank of Canada, Calgary, Alberta

Stock Listing

The TSX Venture Exchange, Toronto, Ontario

Trading symbol: **PNE**



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